

Message Text

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FM AMEMBASSY KINGSTON

TO SECSTATE WASHDC 4595

S E C R E T SECTION 1 OF 3 KINGSTON 1496/1

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E.O. 11652: GDS

TAGS: PINT, EMIN, US JM

SUBJ: BAUXITE NEGOTIATIONS SITREP 33

1. HERewith THE TEXT OF A MEMORANDUM PREPARED BY LLOYD CUTLER
DETAILING THE MEETING HELD THURSDAY EVENING. CUTLER AND CHAPMAN
ROSE REPRESENTED THE INDUSTRY WHILE GOVT WAS REPRESENTED BY
ROUSSEAU, MATALON, RICHARDSON, AND MCINTYRE. CUTLER'S MEMORANDUM
DESCRIBES IN DETAIL THE REVENUE PACKAGE OFFERED TO THE GOVT.

2. BEGIN TEXT: MEMORAMdUM ON AD REFERENDUM PROPOSAL

AT 930 P.M. ON APR 25 MESSRS ROSE AND CUTLER MET IN AN INFORMAL
OFF-THE-RECORD SESSION WITH MESSRS ROUSSEAU, MATALON,
RICHARDSON AND MCINTYRE OF THE JAMAICAN NEGOTIATING TEAM AND
ORALLY PRESENTED A FURTHER PROPOSAL ON THE TAX ISSUES AS SUMM-
ARIZED BELOW:

1. THEY MADE CLEAR THAT THE PROPOSAL WAS BEING SUGGESTED IN-
FORMALLY ON AN "AD REFERENDUM" BASIS, AS ONE TO WHICH THEY WERE
NOT AUTHORIZED TO COMMIT THE COMPANIES BUT ONE TO WHICH THEY WOULD
ATTEMPT TO OBTAIN THE APPROVAL OF THE COMPANIES' CHIEF EXECUTIVES
IF THE NEGOTIATING TEAM COULD STATE INFORMALLY THAT SUCH A PRO-
POSAL MIGHT FORM THE BASIS OF AN AGREEMENT.

2. THE PRtPOSAL WAS PUT FORTH ON THE FOLLOWING EXPRESS ASS-
UMPTIONS:

(A) THAT MUTUALLY SATISFACTORY SOLUTIONS ARE FOUND FOR THE

OTHER "REVENUE ISSUES", E.G. EXCHANGE CONTROL, EXPORT CONTROL,
PAYMENT DATES, ETC. THAT THE GOVT WANTS TO RESOLVE AS PART OF THE
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REVENUE PACKAGE.

(B) THAT THE AGREEMENTS ON THE TAX AND OTHER REVENUE ISSUES WOULD BE EMBODIED IN AN AMENDMENT TO THE EXISTING CONTRACTS PROVIDING THAT EXCEPT AS SO AMENDED ALL PROVISIONS OF THE EXISTING CONTRACTS REMAIN IN FULL FORCE AND EFFECT EXCEPT AS THEY MAY HEREAFTER BE FURTHER AMENDED BY MUTUAL AGREEMENT OF THE PARTIES. AT THE SAME TIME THE PARTIES COULD EXCHANGE LETTERS CONFIRMING THAT OTHER PENDING ISSUES REMAIN UNDER DISCUSSION AND THAT EACH SIDE WOULD CONTINUE TO NEGOTIATE IN GOOD FAITH TO SEEK MUTUALLY AGREEABLE SOLUTIONS.

3. AS THE COMPANIES ANALYZED THE GOVT'S TAX PROPOSAL (US \$15.30 TOTAL REVENUE PER TON OF BAUXITE AT AN INGOT PRICE OF 35 CENTS PER POUND, SUBJECT TO ESCALATION FOR SUBSEQUENT CHANGES IN THE INGOT PRICE) IT AMOUNTS TO A TAX PAYMENT OF 8.7 PERCENT OF THE INGOT PRICE AND IMPLIES A CURRENT VALUE FOR JAMAICAN BAUXITE OF APPROX US\$23.00 PER TON (OR 14PERCENT OF AN INGOT PRICE OF 35 CENTS A POUND) IN THE VIEW OF THE COMPANIES' BASED ON THEIR PRESENT EXPERIENCE IN PURCHASING BAUXITE AT ARMS' LENGTH FOR SHIPMENT TO NORTH AMERICAN PORTS FROM OTHER SOURCES (EG ALCAN'S PURCHASES OF APPROX 3 MILLION TONS PER YEAR FOR SHIPMENT TO ARIVDA, QUEBEC), WITH APPROPRIATE ADJUSTMENTS FOR ALUMINUM CONTENT AND FREIGHT CHARGES, THE CURRENT FAIR VALUE OF JAMACIAN BAUXITE IS APPROX US\$11-12.00 PER TON OR ABOUT 7 PERCENT OF A 35 CENT INGOT PRICE.

4. THE COMPANIES BELIEVE THEY CANNOT AFFORD TO DOUBLE THE EFFECTIVE PRICE OF JAMAICAN BAUXITE AND THE PERCENTAGE IT REPRESENTS OF THE INGOT PRICE FOR TWO PRINCIPLE REASONS: (A) IT WOULD PLACE NORTH AMERICAN COMPANIES RELYING ON JAMAICAN BAUXITE -- AS COMPARED TO OTHER AVAILABLE BAUXITE -- AT A SERIOUS COMPETITIVE COST DISADVANTAGE WHICH THEY MIGHT BE UNABLE TO RECOUP BY PASSING ON THIS COST IN THEIR OWN ALUMINUM OR ALUMINA PRICES. EVEN IF THEY COULD RECOUP THEY WOULD STILL BE AT A SERIOUS PROFIT DISADVANTAGE VIS A VIS COMPANIES OBTAINING BAUXITE FROM OTHER SOURCES, AND LESS ABLE TO COMPETE IN TIME OF MARKET SOFTNESS WHEN ALUMINUM PRICES TRADITIONALLY FALL. THE DISADVANTAGE WOULD BE FELT MOST BY THE COMPANIES WHICH DEPEND MOST ON JAMAICAN BAUXITE. (B) EVEN IF THIS DISADVANTAGE SHOULD DISAPPEAR BECAUSE BAUXITE FROM OTHER SOURCES ALSO SIMILARLY ROSE IN PRICE, THE RESULTING INCREASE IN THE PRICE OF ALUMINUM PRODUCTS COULD LIMIT ALUMINUM'S ABILITY TO GAIN NEW MARKETS BECAUSE OF FAVORABLE HISTORIC PRICE TRENDS VIS A VIS COMPETING MATERIALS THUS CAUSING THE HISTORIC RATE OF GROWTH TO

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FLATTEN OUT.

5. THESE DISADVANTAGES WOULD BE HARMFUL NOT ONLY TO THE COMPANIES BUT ALSO TO JAMAICA, SINCE THEY WOULD TEND TO SHIFT BAUXITE PURCHASING AND INVESTMENT DECISIONS AWAY FROM JAMAICA TO LESS EXPENSIVE SOURCES, AND WOULD ENABLE OTHER BAUXITE PRODUCING AREAS TO EXPAND THE DESIRED UTILIZATION OF THEIR BAUXITE AT A FASTER RATE THAN JAMAICA. THESE DISADVANTAGES WOULD NOT ONLY DETER THE

COMPANIES NOW USING JAMAICAN BAUXITE FROM EXPANDING THEIR ALUMINA PRODUCTION IN JAMAICA; THEY WOULD HAVE A SIMILAR DETERRENT EFFECT ON OTHER COMPANIES CHOOSING BETWEEN JAMAICA AND OTHER COMPETING SOURCES.

6. FOR THESE REASONS THE COMPANIES ARE UNABLE TO ACCEPT A CURRENT VALUE FOR JAMAICAN BAUXITE ANYWHERE NEAR US\$23.00 PER TON OR A RATE OF REVENUE PAYMENT TO THE GOVT ANYWHERE NEAR 8.7 PERCENT OF THE PRICE OF INGOT. ON AN AD REFERENDUM BASIS MESSR ROSE

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AND CUTLER SAID THAT THEY WOULD TRY TO OBTAIN CONCURRENCE FOR AN AGREEMENT ON AN INCREASE OF THE INITIAL COMPANIES' OFFER FROM (A) PRESENT ROYALTIES PLUS A PRODUCTION PAYMENT OF US\$2.50 PER TON AT A 29 CENT INGOT PRICE WITH ESCALATION FOR FUTURE INCREASES IN THE INGOT PRICE TO (B) PRESENT ROYALTIES PLUS US\$4.00 PER TON AT THE 29 CENT LEVEL WITH ESCALATION. THE RESULT OF THIS INCREASE ON THE BASIS OF A 35 CENT INGOT PRICE WOULD BE PAYMENTS TO JAMAICA SLIGHTLY OVER US\$5.00 PER TON, AND THE TOTAL ESTIMATED 1974 ANNUALIZED REVENUE PAYMENT TO THE GOVT WOULD BE APPROX US\$ 80 MILLION, AS COMPARED TO THE APPROX US\$ 25 MILLION THAT THE GOVT WOULD RECEIVE UNDER THE PRESENT RATES, AND THE APPROX US\$48 MILLION THAT THE GOVT WOULD RECEIVE UNDER THE COMPANIES' INITIAL OFFER. AS COMPARED TO THE GOVT PROPOSAL THIS AD REFERENDUM PROPOSAL WOULD IMPLY A VALUE FOR JAMAICAN BAUXITE IN THE RANGE OF US\$11-12.00 PER TON (7 PERCENT OF A 35 CENT INGOT PRICE) INSTEAD OF THE GOVT'S US\$23.00 PER TON (14 PERCENT OF A 35 CENT INGOT PRICE) REVENUE PAYMENTS TO THE GOVT WOULD BE 3 PERCENT OF A 35 CENT INGOT PRICE, AS COMPARED TO THE 8.7 PERCENT PROPOSED BY THE GOVT.

7. IN ADDITION, MESSRS CUTLER AND ROSE SAID THEY WERE PREPARED AD REFERENDUM TO EXPLORE METHODS OF CONSTRUCTING A FORMULA FOR

REDETERMINING THE 3 PERCENT BASE PERCENTAGE TO REFLECT FUTURE CHANGES IN THE TREND LINE OF GROWTH IN ALUMINUM CONSUMPTION, AND TO REFLECT FUTURE CHANGES IN THE PRICE OR COST OF BAUXITE FROM OTHER AREAS THAT SUPPLY NORTH AMERICA. THE AIM OF THESE FORMULAS WOULD BE TO BRIDGE THE CURRENT GAP BETWEEN THE PARTIES--BASED ON JAMAICA'S ASSUMPTIONS AS TO THE LACK OF ADVERSE AFFECT OF THE GOVT'S PROPOSAL ON THE GROWTH OF THE INDUSTRY AND THE PROFITABILITY AND COMPETITIVE POSITION OF THE COMPANIES AND THE COM-
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PANIES' DOUBTS ON THESE POINTS. THE GAP RESULTS FROM DIFFERING ASSUMPTIONS AND PREDICTION AS TO FUTURE MARKET BEHAVIOUR OVER AN EXTENDED PERIOD OF TIME, AS TO WHICH NO ONE, NO MATTER HOW EXTENSIVE HIS DATA, CAN REALLY BE CERTAIN. UNDER THE FORMULA, IF JAMAICA'S ASSUMPTION PROVED CORRECT IN HARD FUTURE FACT, THE BASE PERCENTAGE WOULD RISE RAPIDLY TOWARD THE DESIRED 8.7 PERCENT; TO THE EXTENT THAT FUTURE EVENTS DO NOT CONFIRM THESE ASSUMPTIONS, THE RISE WOULD NOT OCCUR.

8. THE CONSTRUCTION OF APPROPRIATE FORMULAS IS COMPLEX AND WILL REQUIRE FURTHER STUDY. AMONG THOSE THAT COULD BE CONSIDERED ARE THE FOLLOWING:

(A) A FACTOR IN THE ESCALATION (PERHAPS 50 PERCENT) COULD BE THE TREND LINE IN THE GROWTH OF FREE WORLD ALUMINUM CONSUMPTION BASED ON ACTUAL RATE OF GROWTH OVER THE PAST 10 YEARS. IF GROWTH EXCEEDS THIS TREND LINE THE BASE PERCENTAGE WOULD BE ADJUSTED UPWARD PROPORTIONATELY. IF GROWTH FALLS BELOW THIS TREND LINE THE BASE PERCENTAGE WOULD BE REDUCED PROPORTIONATELY.

(B) THE OTHER 50 PERCENT FACTOR COULD BE THE COMPARATIVE PRICE OF BAUXITE FROM OTHER SOURCES. THE PRICE OF BAUXITE FROM OTHER AREAS SHIPPING TO NORTH AMERICA COULD BE MEASURED BY HAVING EACH COMPANY REPORT TO JAMAICA ON A CERTIFIED BASIS ITS ACTUAL CURRENT PRICES FOR ARMS' LENGTH PURCHASES OF BAUXITE SHIPPED TO NORTH AMERICA, WITH APPROPRIATE BALANCING ADJUSTMENT FOR FREIGHT AND ALUMINUM CONTENT. IF ON A WEIGHTED BASIS THIS PRICE AMOUNTS TO

MORE THAN 7 PERCENT OF THE INGOT PRICE, THE 3 PERCENT BASE PERCENTAGE FOR DETERMINING REVENUE PAYMENTS TO HAMAICA WOULD BE INCREASED PROPORTIONATELY.

(C) ALTERNATIVELY, THE VALUE OF BAUXITE FROM OTHER SOURCES COULDBE MEASURED ON A COMPARATIVE COST BASIS TO THE COMPANIES OPERATING IN JAMAICA, INCLUDING IN-COST REVENUE PAYMENTS TO THE GOVT, EXPENSES OF EXTRACTION, AND A REASONABLE RATE OF PROFIT FOR THE EXTRACTING COMPANY, WITH APPROPRIATE ADJUSTMENTS FOR COMPARATIVE ALUMINUM CONTENT AND FREIGHT CHARGES TO NORTH AMERICA. SUCH A PROPOSAL MIGHT, HOWEVER, POSE CONFIDENTIALITY PROBLEMS AS TO THE CERTIFICATION OF NON-JAMAICA COSTS.

(D) ALTERNATIVELY, IF FORMULAS FOR COMPARATIVE BAUXITE VALUES PROVE TO DIFFICULT TO CONSTRUCT, THE CONTRACTS MIGHT PROVIDE FOR REDETERMINATION OF BAUXITE VALUES AT THE OPTION OF EITHER PARTY, SAY EVERY FIVE YEARS, WITH A PROVISIO FOR RESOVLING DISAGREE-

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ORIGINAL CONTRACT WHO WOULD BE EXPERT IN THE FIELD AND WHO
WOULD BE REQUIRED TO MAKE DECISIONS BY FIXED DATES.

(E) IF NONE OF THESE FORMULAS WERE SATISFACTORY THE COMPANIES
WERE PREPARED TO DISCUSS ANY OTHER FORMULA THE GOVT MIGHT PUT
FORWARD FOR ADJUSTING ON THE BASIS OF THESE FACTORS.

MESSRS ROSE AND CUTLER SAID THAT IF A REVENUE AGREEMENT ALONG
THE ABOVE LINES COULD BE REACHED, SEVERAL OF THE COMPANIES WERE
PREPARED TO WORK OUT WITH THE GOVT A PLAN TO BUILD ONE OR MORE NEW
ALUMINA PLANTS AS JOINT VENTURES IN WHICH THE GOVT WOULD OWN A
SUBSTANTIAL INTEREST. THEY SAID THAT IF THE GOVT SO DESIRED, AND
IN ORDER TO ACHIEVE APPROPRIATE ECONOMIES OF SCALE, SEVERAL OF THE
COMPANIES MIGHT BE WILLING TO JOIN WITH THE GOVT IN A SINGLE JOINT
VENTURE OF THE MAGNITUDE 21.5 MILLION TONS OF ALUMINA. THEY SAID
THAT SUCH A JOINT VENTURE WOULD INVOLVE A NUMBER OF COMPLEX
PROBLEMS AS TO THE ACCUMULATION OF ADEQUATE RESERVES, FINANCING
AND CLEARANCE UNDER THE US ANTITRUST LAWS, BUT THAT THE INT-
ERESTED COMPANIES WERE PREPARED TO ADDRESS THESE PROBLEMS SERIOUSLY
AND BELIEVED THAT A BASIC MEMORANDUM OF UNDERSTANDING COULD BE
WORKED OUT ALONG WITH THE EXECUTION OF THE REVENUE AM
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RANGE PROPOSED BY THE GOVT JAMAICAN BAUXITE AND ALUMINA WOULD
BECOME SO COMPARATIVELY HIGH-COST THAT SUBSTANTIAL EXPANSION
OF JAMAICA ALUMINA PRODUCTION BY THE COMPANIES PRESENTLY IN
JAMAICA OR OTHER COMPANIES WAS MOST UNLIKELY.

THE MEMBERS OF THE NEGOTIATING TEAM SAID THEY WERE VERY DIS-
APPOINTED BY THE PROPOSAL, PRIMARILY BECAUSE OF THE BASE PER-
CENTAGE. THEY SAID THE BASE WAS FAR TOO LOW TO MAKE FURTHER
DISCUSSION FRUITFUL. THEY SAID THAT THE PROPOSAL FOR PERIODIC

ADJUSTMENTS TO REFLECT CHANGES IN THE TREND LINE GROWTH IN ALUMINUM CONSUMPTION MADE SENSE AND COULD BE CONSIDERED, BUT THEY REFUSED TO CONSIDER ANY FORMULA FOR ADJUSTMENTS WITH BAUXITE PRICES FROM OTHER SOURCES SUPPLYING NORTH AMERICA AND SAID THAT COMPARATIVE PRICES FROM OTHER SOURCES WAS IRRELEVANT. THEY EXPRESSED CONSIDERABLE INTEREST IN THE SUGGESTION OF ALUMINA EXPANSION BUT SAID THEY COULD NOT ACCEPT THE PROPOSED BASE PERCENTAGE EVEN IF THIS MEANT LOSING THE PROPOSED EXPANSION.

ON SEVERAL OCCASIONS DURING A LONG DISCUSSION OF PROS AND CONS, THE JAMAICA REPRESENTATIVES SAID THAT SINCE THE OFFER WAS SO LOW THERE WOULD BE NO POINT IN HOLDING THE SUB-COMMITTEE MEETINGS ON OTHER ISSUES (E.G. FOREIGN EXCHANGE SCHEDULED FOR THE 26TH). WHEN ASKED IF FURTHER DISCUSSIONS COULD BE HELD ON THE 26TH CONCERNING THE REVENUE RATE THEY SAID THIS WOULD BE POINTLESS UNLESS THE COMPANIES HAD A BETTER OFFER TO MAKE. MESSRS CUTLER AND ROSE REPEATED THAT THEY WERE PREPARED TO CONTINUE DISCUSSIONS IN AN EFFORT TO FIND A FORMULA THAT WOULD BRIDGE THE REVENUE GAP BETWEEN THE TWO SIDES, AND THAT IN THEIR OPINION REASONABLE MEN OUGHT TO BE ABLE TO DEVISE FORMULAS TO COMPOSE THE DIFFERING ASSUMPTIONS OF THE TWO PARTIES AS TO FUTURE MARKET TRENDS, SO THAT THE

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CONTRACT TERMS WOULD ADJUST THEMSELVES TO FIT THE REALITY OF FUTURE MARKET CONDITIONS AS THE DEVELOP. A TENTATIVE ARRANGEMENT WAS ALSO MADE OF A SOCIAL LUNCH ON THE 26TH.

10. THE NEXT DAY MR. CUTLER ATTEMPTED TO PHONE MESSRS ROUSSEAU AND MATALON TO CONFIRM THE LUNCHEON DATE OR POSTPONE IT IF MESSRS ROUSSEAU AND MATALO PREFERRED. HE COULD ONLY REACH MR. ANGUS. MR. ANGUS LATER CALLED BACK TO SAY THAT HE HAD BEEN UNABLE TO REACH MR. ROUSSEAU BUT THAT HE HAD FOUND A NOTE FROM MR. ROUSSEAU INDICATING THAT MESSRS CUTLER AND ROSE WERE LEAVING TODAY. MR. CUTLER STATED THAT HE WAS NOT LEAVING AND THAT WHILE SOME OF THE COMPANY GROUP WOULD BE RETURNING TO MIAMI BRIEFLY TO REPORT, HE AND MR. ROSE AND THE GROUP INTENDED TO REMAIN THROUGH THE 29TH OR AS LONG THEREAFTER AS THE JAMAICA NEGOTIATING TEAM DESIRED.

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